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Openness to Foreign Investment

¶1. In the past several years, Bosnia and Herzegovina (BiH) has made considerable efforts to open its economy to more foreign investment. However, the global economic crisis, coupled with increasing internal political struggles, has led to a significant slowdown in necessary reforms since 2008. Previous initiatives included a liberal state-level foreign investment policy, a value-added tax, and a uniform trade and customs policy. Foreign investors continue to face a number of serious obstacles, including a complex legal and regulatory framework, non-transparent business procedures, and weak judicial structures. Privatization of state-owned enterprises continues to lag behind others in the region including Croatia, Serbia, Montenegro, and Macedonia. Although some government authorities have begun to address these obstacles as part of the transition to a market economy, foreign investment -- particularly greenfield investment -- has shown only limited gains. Foreign investment in the banking sector is the exception, with Austrian banks taking a dominant position in the local market.

¶2. BiH will need to address three fundamental issues in the near term to further economic reform:

-- Complex legal and regulatory framework: Under the constitution established through the Dayton Accords, Bosnia and Herzegovina is divided into two sub-federal "entities," the Federation of BiH (FBiH) and the Republika Srpska (RS). A third, smaller area, the Brcko District, operates under separate administration. The establishment of governmental structures at the state (federal) and entity levels created a multi-tiered legal and regulatory framework that is often duplicative and contradictory. For example, current employer contributions on net wages total 69 percent in FBiH and 52 percent in the RS. There has been some progress: corporate income taxes in the two entities and Brcko District have been harmonized at ten percent, for example. Nonetheless, the lack of a single economic space has a chilling effect on job creation in the formal economy and creates difficulties for companies trying to do business in the entire country. Entity business registration requirements are not harmonized. The Federation, for example, is comprised of ten cantons, and each canton has different business regulations and administrative procedures affecting companies. Simplifying and streamlining this framework is essential to improving the investment climate.

-- Business regulations and administrative procedures: With multiple layers of administration, opportunities for corruption abound, increasing the cost of doing business. In particular, public procurement tenders are not always transparent. Even though European Union-compliant public procurement legislation has been adopted, it has not been adequately enforced. The World Bank rates Bosnia and Herzegovina 116 out of 183 countries (2010 World Bank Doing Business Report) in ease of doing business. (Bosnia's ranking for ten aspects of doing business can be found at www.doingbusiness.org/ExploreEconomies/?econo myid=26)

-- Weak judicial structures: BiH's legal/judicial system provides no

means for quick resolution of commercial disputes. Commercial courts do not exist and non-judicial dispute resolution mechanisms are few. Legal judgments in commercial disputes often appear to be less than objective. One positive development was the creation of the Competition Council in 2004, an independent public institution mandated to enforce anti-trust laws, prevent monopolies, and enhance private sector competition. The Council reviews and approves foreign investments in cases of mergers and acquisitions of local companies by foreign companies. It has created a refreshing level of transparency in the local legal system - an organization yet to be tainted by the country's political scene.

¶3. Investment Law: The state-level "Law on Foreign Direct Investment" provides a generic framework for foreign investment. The law accords foreign investors the same rights as domestic investors, including bidding on privatization tenders. With the exception of the defense industry and the media sector, where foreign control is limited to 49 percent, there are no restrictions on investment. Investors are also protected from changes in laws regarding foreign investment. Should the government make changes, the investor may choose the most favorable set of rules to apply. The law prohibits expropriation and nationalization of assets, except under special circumstances and with due compensation.

¶4. BiH's Foreign Investment Promotion Agency provides some assistance to foreign investors, but is constrained by limited staff and budgetary resources. (www.fipa.gov.ba)

¶5. Public-private partnerships, particularly in the health-care and transportation sectors, are gradually gaining wider acceptance with Bosnian officials. In December 2008, the RS approved a law authorizing public-private partnerships in a large group of sectors, including transportation, energy, and health care.

Conversion and Transfer Policies

¶6. The Law on Foreign Direct Investment also guarantees the immediate right to transfer and repatriate profits and remittances and allows local and foreign companies to hold accounts in one or more banks authorized to initiate or receive payments in foreign currency. The implementing laws in both entities include transfer and repatriation rights. The Central Bank's adoption of a currency board in 1997 guarantees that the local currency, the convertible mark or KM, is fully convertible and fixed at an exchange rate of KM 1.95583 to the euro. From January through October 2009, annualized inflation was -1.4 percent, compared to +0.5 percent in the EU-27 (source: Central Bank BiH). The largest price decreases over this period were in transportation, clothing, footwear, food, and non-alcoholic beverages, while prices rose for alcoholic beverages, tobacco, restaurants, hotels, electricity, gas, and other fuels. Central Bank reserves have risen steadily, registering over USD 4.8 billion in October 2009, a sign of the continued strength of the currency board.

Expropriation and Compensation

¶7. As noted above, the state investment law forbids expropriation of investments, except in the public interest. According to Article 16, "foreign investment shall not be subject to any act of nationalization, expropriation, requisition or measures that have similar effects, except where the public interest may require otherwise." In such cases, all procedures are executed in accordance with applicable laws and regulations, without any type of discrimination and with payment of appropriate compensation. Laws in both entities implement this guidance. Neither entity governments nor the state government has expropriated any foreign investments to date.

Dispute Settlement

¶8. BiH has recently implemented significant changes to court operations and staffing, designed to streamline commercial and other proceedings. The U.S. Government is implementing a number of court reform programs which should expedite case processing and further develop judicial capacity. The U.S. Government also provided

training and resource materials to judges, trustees, attorneys, and other stakeholders to assist in the development of new bankruptcy and intellectual property rights laws. BiH courts recently completed their first bankruptcy cases under new bankruptcy legislation, and early indications are that the system functions well.

¶9. Over the past few years there has been only one case of a legal dispute involving a U.S. investor and the local government. Although this dispute remains unresolved, the claimant is currently pursuing negotiations with the local government and has not opted for international mediation. While the outlook for BiH's commercial court system is positive, capacity and practical inefficiencies limit timely resolution of commercial disputes.

¶10. Bosnia and Herzegovina has been a member of the International Center for the Settlement of Investment Disputes since 1997. It accepts international arbitration to settle private investment disputes if the parties outline this option in a contract.

Performance Requirements and Incentives

¶11. There are several incentives for foreign direct investment, including exemptions from payment of customs duties and customs fees. Bosnia and Herzegovina is divided into three jurisdictions for direct tax purposes: the Federation of BiH, the Republika Srpska and the Brcko District. The corporate income tax in the Federation allows tax relief to foreign investors who invest KM 20 million KM (roughly USD 15 million in January 2010) over a five year period. In the Brcko District, the corporate income tax allows offsetting of profits against losses over a five-year period. Foreign investors can open bank accounts in all jurisdictions and transfer abroad the funds acquired from their profits, without any restrictions.

Right to Private Ownership and Establishment

¶12. Under the state-level investment law, a foreign enterprise has the same rights as a Bosnian enterprise or citizen, and foreign entities can establish and own a business with the same rights as domestic entities. Foreign investors may own real estate in BiH and enjoy the same property rights as BiH citizens and legal entities, except in the defense industry and media, where foreign control is limited to 49 percent. Foreign interests must follow the same regulatory procedures when establishing their enterprises.

Property Registers

¶13. Bosnian property registers are largely unreliable. Under laws of both entities, property transfers must be registered with municipal authorities. In practice, however, transactions are often not recorded due to high transfer taxes. This leads to inaccurate and unreliable property records that leave property transfers open to dispute. In 2004 BiH passed a state-level framework law to create a moveable pledge registry. The registry became operational as of January 2005. In 2007, Brcko District passed a real estate property law annulling previous conflicting laws and developed a new workable registry. The Republika Srpska adopted a similar registry system in January 2010.

Protection of Property Rights

¶14. The BiH government is strengthening its intellectual property rights laws in preparation for eventual membership in the European Union and the World Trade Organization. Bosnia's new IPR framework consists of seven laws, all of which have been recently submitted to the parliament for adoption. Although existing legislation provides a basic level of protection, BiH's civil and criminal enforcement remains weak. Jurisdiction over IPR investigations is split between customs officials and local law enforcement agencies and no institution has specialized IPR investigation teams. The court system is also inefficient and the few indictments actually brought to court have languished for months with little action from prosecutors or judges. However, there are signs of progress-BiH

filed its first ever indictment in a software piracy case in December and the U.S. in conjunction with local partners has made IPR awareness within the enforcement community a priority.

¶15. In the Bosnian private sector, awareness of IPR, particularly the importance of copyright protection, remains low. Curbing business software piracy could significantly improve the local economy through the creation of new jobs and the generation of significant tax revenue. This failure to recognize the importance of reducing copyright infringement makes software producers and official distributors less competitive and the establishment of a legitimate market more difficult. According to the Business Software Alliance, the rate of illegal software installed on personal computers in Bosnia and Herzegovina last year dropped by another one percent from the year before and currently stands at 67 percent, which is about average for the region.

¶16. In addition to the software piracy indictment, there are other indicators that BiH is strengthening its IPR enforcement regime. Entity and state-level governments have agreed to legalize and license their use of Microsoft software, a significant step forward in the government's commitment to IPR protection. In 2006, Microsoft and Oracle successfully reached a legalization agreement with one of BiH's electric utilities, one of the largest state-owned businesses in the country. Although illegal DVDs and CDs are still available for sale in small public markets, local authorities have made an effort to dismantle larger venues, such as Sarajevo's notorious "CD Alley." In 2008, customs officials seized over 170,000 counterfeit products that included logo emblems of Nike, Adidas, Puma and Diesel apparel and footwear and they have also interdicted shipments of fake Viagra.

Transparency of the Regulatory System

¶17. Establishing a business in Bosnia can be an extremely burdensome and time-consuming process for investors. Registration is a 12-step procedure that takes on average one month to complete. Retaining a local lawyer can sometimes expedite the process. The administrative costs are approximately USD 450 and attorney fees range from USD 200 to USD 1,000. Businesses must register in each entity in which they wish to conduct operations. However, investors in one entity may register their business as a branch in the other entity, significantly reducing the time and administrative hurdles to begin operations. Other administrative procedures can be even more time-consuming. For example, obtaining a construction permit can take six months to one year.

¶18. The multitude of state, entity, cantonal (in the Federation only), and municipal administrations - each with the power to establish laws and regulations affecting business -- creates a heavily bureaucratic, non-transparent system. It is difficult to know all of the laws or rules that might apply to certain business activities, given overlapping jurisdictions and the lack of any central source of information. It is therefore critical that foreign investors obtain local assistance and advice.

¶19. Businesses are subject to inspections from a number of entity and cantonal/municipal agencies including the financial police, labor inspectorate, market inspectorate, sanitary inspectorate, health inspectorate, fire-fighting inspectorate, environmental inspectorate, institution for the protection of cultural monuments, tourism and catering inspectorate, construction inspectorate, communal inspectorate, and veterinary inspectorate.

Efficient Capital Markets and Portfolio Investment
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¶20. Capital markets remain underdeveloped in Bosnia. Both entities have created their own modern stock market infrastructure with separate bourses in Sarajevo (SASE) and Banja Luka (BLSE), both of which started trading in 2002. The small sizes of the market, lack of progress on privatization, and public mistrust of previous voucher privatization programs have impeded the development of a market. Nonetheless, both stock exchanges experienced a significant boom in the first half of 2007, supported by strong performances in neighboring stock markets in Belgrade, Zagreb, and Ljubljana. However, during the second half of 2007 and throughout 2008 foreign

investment dwindled and investors saw previous gains dissipate on both exchanges. While this has not had a significant impact on the broader Bosnian economy, it is a setback to the development of Bosnia's capital market. For example, in 2008 the BLSE had a turnover smaller than KM 250 million ($180 million), compared to BAM 700 million ($500 million) in 2007. This downward trend continued in 2009, shaped not only by the global financial crisis but also by Bosnia's own political instability and reform slowdown.

¶21. Standard & Poor's issued its first sovereign credit rating for Bosnia and Herzegovina in December 2008. In 2009, the agency upgraded Bosnia's long-term foreign and local currency government bond to a "B+ rating." Both S&P and Moody's maintain a "stable" outlook for Bosnia and Herzegovina. By contrast, in November 2009, Dun & Bradstreet downgraded Bosnia's credit rating from DB5c to DB6a, citing political instability as the key factor for the downgrade.

¶22. Bosnia and Herzegovina, since the end of the war, has had a relatively stable banking and financial system, with the most significant investment coming from Austria. The banks' weathering of the recent global financial crisis is an indication of its stability, but also its lack of exposure to external markets. Bosnia's Central Bank noted in December 2008 that citizens withdrew more than KM 800 million (USD 571 million) from commercial banks since the start of the financial crisis, although the trend has certainly slowed from its peak in September/October 2008 and an increasing number of deposits have been made during 2009, indicating a return to confidence in the financial system.

¶23. In 2004 BiH passed a state-level framework law mandating the use of international accounting standards, and in 2005 both entities passed legislation eliminating the previous differences between the entities and Brcko District. All governments have implemented accounting practices that are fully in line with international norms. However, these standards have not yet been internalized throughout the country due to weak accounting capacity, and the standards are continually threatened by legislative officials attempting to protect local accounting firms. Foreign investors should therefore carefully scrutinize Bosnian corporate financial statements.

Competition from State-Owned Enterprises (SOEs)

¶24. Generally, private companies are allowed to compete with public enterprises under the same terms and conditions with respect to access to markets, credit and other business operations. However, in the sectors such as telecommunications and electricity, state-owned enterprises hold a near-monopoly, making hefty profits as a direct result of their dominant market position.

Corporate Social responsibility (CSR)

¶25. Foreign and local companies exercise a variable level of corporate social responsibility and awareness. In general, consumers tend to view favorably companies that initiate and carry out charitable activities in the local market.

Political Violence

¶26. The war in Bosnia and Herzegovina was halted by the Dayton Peace Accords in November 1995. Armed conflict has ceased and there have been no attacks targeting foreign investments. However, there are still risks from occasional, localized political and criminal violence.

Corruption

¶27. Corruption, including bribery, raises the costs and risks of doing business. Corruption has a corrosive impact on both market opportunities overseas for U.S. companies and the broader business climate. It also deters international investment, stifles economic growth and development, distorts prices, and undermines the rule of law.

¶28. It is important for U.S. companies, irrespective of their size, to assess the business climate in the relevant market in which they will be operating or investing, and to have an effective compliance program or measures to prevent and detect corruption, including foreign bribery. U.S. individuals and firms operating or investing in foreign markets should take the time to become familiar with the relevant anticorruption laws of both the foreign country and the United States in order to properly comply with them, and where appropriate, they should seek the advice of legal counsel.

¶29. The U.S. Government seeks to level the global playing field for U.S. businesses by encouraging other countries to take steps to criminalize their own companies' acts of corruption, including bribery of foreign public officials, by requiring them to uphold their obligations under relevant international conventions. A U. S. firm that believes a competitor is seeking to use bribery of a foreign public official to secure a contract should bring this to the attention of appropriate U.S. agencies, as noted belQ

¶30. U.S. Foreign Corrupt Practices Act: In 1977, the United States enacted the Foreign Corrupt Practices Act (FCPA), which makes it unlawful for a U.S. person, and certain foreign issuers of securities, to make a corrupt payment to foreign public officials for the purpose of obtaining or retaining business for or with, or directing business to, any person. The FCPA also applies to foreign firms and persons who take any act in furtherance of such a corrupt payment while in the United States. For more detailed information on the FCPA, see the FCPA Lay-Person's Guide at: www.justice.gov/criminal/fraud/docs/dojdocb.h tml

¶31. Other Instruments: It is U.S. GovernmeQolicy to promote good governance, including host country implementation and enforcement of anti-corruption laws and policies pursuant to their obligations under international agreements. Since enactment of the FCPA, the United States has been instrumental to the expansion of the international framework to fight corruption. Several significant components of this framework are the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (OECD Antibribery Convention), the United Nations Convention against Corruption (UN Convention), the Inter-American Convention against Corruption (OAS Convention), the Council of Europe Criminal and Civil Law Conventions, and a growing list of U.S. free trade agreements.

¶32. OECD Antibribery Convention: The OECD Antibribery Convention entered into force in February 1999. As of December 2009, there are 38 parties to the Convention including the United StaQ(see www.oecd.org/dataoecd/59/13/40272933.pdf). Major exporters China, India, and Russia are not parties, although the U.S. Government strongly endorses their eventual accession to the Convention. The Convention obligates the Parties to criminalize bribery of foreign public officials in the conduct of international business. The United States meets its internatQal obligations under the OECD Antibribery Convention through the U.S. FCPA.

¶33. UN Convention: The UN Anticorruption Convention entered into force on December 14, 2005, and there are 143 parties to it as of December 2009 (see www.unodc.org/unodc/en/treaties/CAC/signatori es.html). The UN Convention is the first global comprehensive international anticorruption agreement. The UN Convention requires countries to establish criminal and other offences to cover a wide range of acts of corruption. The UN Convention goes beyond previous anticorruption instruments, covering a broad range of issues ranging from basic forms of corruption such as bribery and solicitation, embezzlement, trading in influence to the concealment and laundering of the proceeds of corruption. The Convention contains transnational business bribery provisions that are functionally similar to those in the OECD Antibribery Convention and contains provisions on private sector auditing anQoks and records requirements. Other provisions address matters such as prevention, international cooperation, and asset recovery.

¶34. OAS Convention: In 1996, the Member States of the Organization of American States (OAS) adopted the first international anticorruption legal instrument, the Inter-American Convention against Corruption (OAS Convention), which entered into force in

March 1997. The OAS Convention, among other things, establishes a set of preventive measures against corruption provides for the criminalization of certain acts of corruption, including transnational bribery and illicit enrichment, and contains a series of provisions to strengthen the cooperation between its States Parties in areas such as mutual legal assistance and technical cooperation. As of December 2009, the OAS Convention has 33 parties (see www.oas.org/juridico/english/Sigs/b-58.html)

¶35. Council of Europe Criminal Law and Civil Law Conventions: Many European countries are parties to either the Council of Europe (CoE) Criminal Law Convention on Corruption, the Civil Law Convention, or both. The Criminal Law Convention requires criminalization of a wide range of national and transnational conduct, including bribery, money-laundering, and account offenses. It also incorporates provisions on liability of legal persons and witness protection. The Civil Law Convention includes provisions on compensation for damage relating to corrupt acts, whistleblower protection, and validity of contracts, inter alia. The Group of States against Corruption (GRECO) was established in 1999 by the CoE to monitor compliance with these and related anti-corruption standards. Currently, GRECO comprises 46 member States (45 European countries and the United States). As of December 2009, the Criminal Law Convention has 42 parties and the Civil Law Convention has 34 (see www.coe.int/greco)

¶36. Free Trade Agreements: While it is U.S. Government policy to include anticorruption provisions in free trade agreements (FTAs) that it negotiates with its trading partners, the anticorruption provisions have evolved over time. The most recent FTAs negotiated now require trading partners to criminalize "active bribery" of public officials (offering bribes to any public official must be made a criminal offense, both domestically and trans-nationally) as well as domestic "passive bribery" (solicitation of a bribe by a domestic official). All U.S. FTAs may be found at the U.S. Trade Representative Website:
www.ustr.gov/trade-agreements/free-trade-agre ements

¶37. Local Laws: U.S. firms should familiarize themselves with local anticorruption laws, and, where appropriate, seek legal counsel. While the U.S. Department of Commerce cannot provide legal advice on local laws, the Department's U.S. and Foreign Commercial Service can provide assistance with navigating the host country's legal system and obtaining a list of local legal counsel.

¶38. Assistance for U.S. Businesses: The U.S. Department of Commerce offers several services to aid U.S. businesses seeking to address business-related corruption issues. For example, the U.S. and Foreign Commercial Service can provide services that may assist U.S. companies in conducting their due diligence as part of the company's overarching compliance program when choosing business partners or agents overseas. The U.S. Foreign and Commercial Service can be reached directly through its offices in every major U.S. and foreign city, or through its Website at www.trade.gov/cs

¶39. The Departments of Commerce and State provide worldwide support for qualified U.S. companies bidding on foreign government contracts through the Commerce Department's Advocacy Center and State's Office of Commercial and Business Affairs. Problems, including alleged corruption by foreign governments or competitors, encountered by U.S. companies in seeking such foreign business opportunities can be brought to the attention of appropriate U.S. government officials, including local embassy personnel and through the Department of Commerce Trade Compliance Center "Report A Trade Barrier" Website at tcc.export.gov/Report_a_Barrier/index.asp

¶40. Guidance on the U.S. FCPA: The Department of Justice's (DOJ) FCPA Opinion Procedure enables U.S. firms and individuals to request a statement of the Justice Department's present enforcement intentions under the antibribery provisions of the FCPA regarding any proposed business conduct. The details of the opinion procedure are available on DOJ's Fraud Section Website at www.justice.gov/criminal/fraud/fcpa. Although the Department of Commerce has no enforcement role with respect to the FCPA, it supplies general guidance to U.S. exporters who have questions about the FCPA and about international developments concerning the FCPA. For further information, see the Office of the Chief Counsel for International Counsel, U.S. Department of Commerce, Website, at

www.ogc.doc.gov/trans_anti_bribery.html. More general information on the FCPA is available at the Websites listed below.

¶41. Exporters and investors should be aware that generally all countries prohibit the bribery of their public officials, and prohibit their officials from soliciting bribes under domestic laws. Most countries are required to criminalize such bribery and other acts of corruption by virtue of being parties to various international conventions discussed above.

¶42. Corruption remains prevalent in many political and economic institutions. The overly-complex business registration and licensing process is particularly vulnerable to corruption. With the large number of officials involved, there are multiple opportunities to demand "service fees." Domestic and international entrepreneurs often have been known to pay bribes to obtain necessary business licenses, or simply to expedite the approval process.

¶43. Local authorities do not generally accept degrees from international universities, creating problems for some locals, many foreign investors and other foreign businessmen. Due to an outdated law that has yet to be revised, employees of government, business and financial institutions that have foreign degrees are obliged to get these degrees "validated" by the local authorities. The process for validation is rather obtuse, and opens the door for rent-seeking from local officials.

¶44. Transparency International operates a branch office in BiH. Its 2009 Corruption Perception Index ranked Bosnia and Herzegovina 99th out of 180.

Anti-Corruption Resources

¶45. Some useful resources for individuals and companies regarding combating corruption in global markets include the following:

Q Information about the U.S. Foreign Corrupt Practices Act (FCPA), including a "Lay-Person's Guide to the FCPA" is available at the U.S. Department of Justice's Website at: www.justice.gov/criminal/fraud/fcpa

Q General information about anticorruption initiatives, such as the OECD Convention and the FCPA, including translations of the statute into several languages, is available at the Department of Commerce Office of the Chief Counsel for International Commerce Website: www.ogc.doc.gov/trans_anti_bribery.html.

Q Transparency International (TI) publishes an annual Corruption Perceptions Index (CPI). The CPI measures the perceived level of public-sector corruption in 180 countries and territories around the world. The CPI is available at: www.transparency.org/policy_research. TI also publishes an annual Global Corruption Report which provides a systematic evaluation of the state of corruption around the world. It includes an in-depth analysis of a focal theme, a series of country reports that document major corruption related events and developments from all continents and an overview of the latest research findings on anti-corruption diagnostics and tools.

Q The World Economic Forum publishes the Global Enabling Trade Report, which presents the rankings of the Enabling Trade Index, and includes an assessment of the transparency of border administration (focused on bribe payments and corruption) and a separate segment on corruption and the regulatory environment.

Q Global Integrity, a nonprofit organization, publishes its annual Global Integrity Report, which provides indicators for 92 countries with respect to governance and anti-corruption. The report highlights the strengths and weaknesses of national level anti-corruption systems. The report is available at: http://report.globalintegrity.org/

Bilateral Investment Protection Agreements

¶46. BiH has signed/ratified 42 agreements to promote and protect investments with the following countries: Albania, Austria, Belgium, Belarus, China, Croatia, Czech Republic, Denmark, Egypt, Finland,

France, Germany, Greece, Netherlands, Hungary, India, Iran, Italy, Jordan, Kuwait, Lithuania, Luxembourg, Macedonia, Malaysia, Moldova, Montenegro, Netherlands, Pakistan, Portugal, Qatar, Romania, Serbia, Libya, Slovakia, Slovenia, Spain, Sweden, Switzerland, Turkey, UAE, Ukraine, and the United Kingdom

BiH does not have a bilateral investment treaty with the United States.

OPIC and Other Investment Insurance Programs

¶47. OPIC's activities in Bosnia include: insurance for investors against political risk, coverage of losses due to expropriation of assets, political violence, and currency inconvertibility; and insurance coverage for contracting, exporting, licensing and leasing transactions.

¶48. Political risk insurance is also available from the EU Investment Guarantee Trust for Bosnia and Herzegovina, administered by the Multilateral Investment Guarantee Agency, a World Bank affiliate.

Labor

¶49. BiH has an educated workforce with relatively low labor costs. However, several sectors such as construction, information technology, and health care have experienced a significant loss of skills and staff over the past decade, due to a lack of educational opportunities and emigration. Tax rates on labor are high, discouraging hiring of new workers and increasing incentives for unregistered employment. In addition, a rigid wage determination system stands in the way of job creation and worker mobility. This is a result of a collective bargaining system that retains most of its socialist era characteristics. Employees and employers share the costs of health care, pension, and unemployment insurance in the Federation while in the Republika Srpska all of these costs are borne by employers. In the Republika Srpska, employers also bear child care contributions. Many employers underreport their labor force in order to avoid paying taxes and benefits. While official unemployment is approximately 40 percent, "unofficial" estimates of unemployment that include the large gray economy are approximately 18-22 percent.

Foreign Trade Zones/Free Ports

¶50. The BiH Law on Free Trade Zones allows the establishment of free trade zones (FTZs) as part of the customs territory of BiH. One or more domestic or foreign legal entities registered in BiH can create a FTZ. The users of FTZs do not pay taxes and contributions, with the exception of those related to salaries and wages. Investors are free to invest capital in the FTZ, transfer their profit and retransfer capital. Customs and tariffs are not paid on imports into the FTZ. The import of equipment that will be used for manufacturing within the FTZs can be discontinued if the value of goods produced and exported abroad is less than 75 percent of the total value of goods produced in that zone. Currently there are four free trade zones in BiH: Vogosca, Visoko, Hercegovina-Mostar, Holc Lukavac.

Foreign Direct Investment (FDI) Statistics

¶51. Between January and November 2009, new foreign direct investment in BiH totaled EUR 268 million (USD 350 million). This was down from a peak of USD 2.1 billion in 2007 and a 51% drop compared with the first eleven months of 2008. Investments from Austria, Germany, Slovenia, Turkey, Croatia, Russia, Montenegro, Serbia, Saudi Arabia, and Belgium predominated in 2009. The manufacturing sector had the highest percentage of FDI, followed by the banking and trade sectors. (Source: FIPA-Foreign Investment Promotion Agency of Bosnia and Herzegovina.)

¶52. BiH has signed free trade agreements with Albania, Croatia, Macedonia, Moldova, Montenegro, Serbia, UNMIK/Kosovo and Turkey. It has preferential export regimes with Australia, Canada, Japan, New

Zealand, Norway, Russia, Switzerland and USA. According to the preferential export regime with the European Union, all goods of BiH origin that fulfill EU technical standards and conditions can be imported to all 27 European Union member states until the end of 2010 without any quantitative restrictions and without paying customs and other similar duties. In December 2006, Bosnia and Herzegovina signed the Central European Free Trade Agreement (CEFTA) which became fully operational in November 2007. The regional trade group includes Albania, Bosnia and Herzegovina, Croatia, Macedonia, Serbia, Montenegro, Kosovo and Moldova. In 2008, Bosnia and Herzegovina signed the Stabilization and Association Agreement (SAA) with the European Union, a step towards EU membership. The SAA establishes a free trade zone between Bosnia and Herzegovina and the European Union, implying the mutual abolishment of all custom tariffs and quantity limitations in goods between the two. The SAA should encourage further development of competitiveness among the country's exporters and increase investments and employment. As of January 1, 2009, import tariffs were eliminated for 11,000 products that BiH imports from the EU.

ENGLISH